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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

NATIONAL FRUIT PRODUCT COMPANY, INCORPORATED,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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H. BRICE GRAVES
JOHN W. RIELY
Electric Building
Richmond 12, Virginia
Counsel for Petitioner

HUNTON, WILLIAMS, ANDERSON, GAY & MOORE
Of Counsel

Dated March 17, 1953

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

National Fruit Product Company, Incorporated, respectfully prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Fourth Circuit. The judgment affirmed an order of the United States District Court for the Western District of Virginia, at Harrisonburg, entered May 26, 1952 (R. 28), denying Petitioner a refund of excess profits tax for its taxable year ended June 30, 1946.

OPINIONS BELOW

The opinion of the District Court is reported in 105 F. Supp. 658.

The *per curiam* opinion of the Court of Appeals is reported in 199 F. (2d) 754.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1952. A petition for rehearing, seasonably filed, was denied on December 18, 1952. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

STATUTES INVOLVED

Pertinent portions of the Internal Revenue Code and of the Revenue Act of 1945 are copied in the Appendix.

QUESTION PRESENTED

For the year ended June 30, 1948, after expiration of the World War II excess profits tax and termination of the privilege of carrying back an unused excess profits credit, the

Petitioner sustained a net operating loss that was carried back to the year ended June 30, 1946. In that year the excess profits credit was computed under the invested capital method, but in fiscal 1948, when the net operating loss was incurred, no excess profits credit was computed because the excess profits tax has been repealed. Was the Commissioner of Internal Revenue authorized, in determining the excess profits tax liability for fiscal 1946,[1] in reducing the net operating loss carry-back from fiscal 1948 by one-half of the interest accrued on notes outstanding in fiscal 1948 although the statute required that reduction only if the excess profits credit for fiscal 1948 was computed on the invested capital method and no credit was computed; and, in addition, if such a credit were to be computed, it should properly be computed on the income method?

As the Court of Appeals recognized, fairness requires a negative answer to this question; the words of the statute lead to a negative answer; the decisions below to the contrary are erroneous and the orderly administration of the revenue laws requires their reversal.

STATEMENT

Petitioner sustained a net loss from operations for its 1948 fiscal year. One of the deductions making up that loss was $106,564.66, representing interest on outstanding notes. Petitioner seasonably filed a claim for refund of fiscal 1946 income and excess profits taxes previously paid for that year. The basis for the refund claim was that the fiscal 1948 net operating loss constituted, after adjustments not here

[1] When we speak of fiscal 1946, we speak of the year ended June 30, 1946, and thus a taxable year subject in part to the excess profits tax since it began before December 31, 1945, the effective date of the repeal of the excess profits tax (Revenue Act of 1945, § 122(a)).

in question, a net operating loss deduction for fiscal 1946, the second year preceding the loss.

The Commissioner of Internal Revenue, in determining the excess profits tax refund, reduced the net operating loss deduction for fiscal 1946 by $53,282.33, representing one-half the interest accruing in fiscal 1948 on outstanding notes. Refunds or credits of fiscal 1946 income and excess profits taxes, the latter computed by taking into account only the reduced net operating loss deduction, have been received by Petitioner and are not in question. The only issue involved in the controversy, and the basis for the suit in the District Court, is whether the Commissioner was authorized to reduce the net operating loss deduction by the $53,282.33.

The excess profits credit of Petitioner for fiscal 1946 was computed under §714,[2] providing for the invested capital method.

SUMMARY OF ARGUMENT

1. The reduction of the fiscal 1948 net operating loss by one-half the interest accrued on notes then outstanding, for purposes of determining the fiscal 1946 net operating loss deduction, is required only if the fiscal 1948 excess profits credit "was computed" under the invested capital method. Since there was not any excess profits tax for fiscal 1948 and the credit for that year was not computed under the invested capital, income or any other method, the adjustment is not required.

2. Even if, as held by the Court below, the statute requires the computation of a "theoretical" excess profits credit for fiscal 1948, the adjustment is not required. This

[2] All references to statutes will be to the Internal Revenue Code unless otherwise specified.

is true because of §712 which requires that the credit be computed on the income method or the invested capital method, whichever results in the lesser tax for the taxable year in respect of which the tax is being computed. This year cannot be fiscal 1948 but must be fiscal 1946; the use of the income method of computing the credit would result in the lesser tax for fiscal 1946; and when the income method is used the adjustment for interest is not required.

ARGUMENT

1. The Interest Adjustment Is Not Required Because an Excess Profits Credit Was Not Computed for Fiscal 1948 Under the Invested Capital Method.

As its name implies, the excess profits tax of World War II was designed to subject to tax, at very high rates, only those profits that were excessive. In determining what might be considered as normal profits, exempt from the tax, Congress allowed all taxpayers to compute an excess profits credit, the amount of which was deducted from excess profits net income in determining the profits subject to tax. The excess profits credit could be determined by using a percentage of average income earned during the base period years 1936-1939, provided by §713, or by using a percentage of invested capital, provided by §714. Section 712(a) required taxpayers to compute the excess profits credit under §713 or §714, "whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed".

Section 711(a) provided for the general rule that the excess profits net income, from which the credit was deducted in determining the income subject to tax, is the "normal-tax net income" with certain adjustments. Normal tax net income is a concept of Chapter I of the Code dealing with the income tax, and for our purposes the term is

equivalent to "net income"—gross income minus the deductions allowed by the statute. Thus the starting point for determining excess profits net income is the net income computed for income tax purposes.

The first computation, therefore, has reduced gross income by all the deductions allowed by §23. One of those deductions is the net operating loss deduction, allowed by §23(s), and that deduction is defined in and computed pursuant to the provisions of §122. The net operating loss deduction, just as the deductions for business expenses, wages, rent and interest, is allowed in determining net income whether or not an excess profits tax is in effect.

For fiscal 1946 the taxpayer computed its excess profits credit pursuant to the invested capital method provided by §714. For taxpayers using that method of computing the credit, §711(a)(2) required certain adjustments to normal tax net income in arriving at excess profits net income. One of those adjustments, contained in §711(a)(2)(B), was that interest on borrowed capital should not be deducted in full as in the determination of normal tax net income but only to the extent of 50%. The reason for this was that 50% of borrowed capital (indebtedness represented by certain credit instruments such as bonds and notes, specified in §719) was included in the invested capital base used to determine the excess profits credit by this method. This same scheme is followed in the present excess profits tax except that the present statute allows 75% of such indebtedness to be included in the base of the credit computation and disallows 75% of the interest paid on such indebtedness as a deduction. §§437(b)(2)(C) and 433(a)(1)(N)

Somewhat similar adjustments were required in respect of operating loss carry-backs.[3] In determining the amount of the net operating loss deduction (for the taxable year),

[3] See §711(a)(2)(L)(i) and §711(a)(1)(J)(i).

the statute required that the net operating loss (for the year of the loss) must be reduced by 50% of the interest on borrowed capital if the excess profits credit for the loss year "was computed" under the invested capital method.

Petitioner made the interest adjustment as to interest accrued in fiscal 1946 in determining its excess profits net income for fiscal 1946. That is the adjustment required by §711(a)(2)(B) [discussed in the second paragraph above] and it is not in question here. What is in question is whether an interest adjustment is required for fiscal 1948 in determining the amount of the 1948 loss that may be carried back to fiscal 1946. That is the matter referred to in the next preceding paragraph. The purpose of those provisions is important for it is determinative of the issue presented here. If a taxpayer has a net operating loss there also will be an unused credit, which also may be carried back (§710(c)), and if the credit for carry-back purposes is computed under the invested capital method (obtaining the advantage of 50% of borrowed capital) the interest adjustment should be made to the operating loss. Only in this manner can the carry-back of both loss and credit be accomplished with fairness to both parties.

The repeal of the excess profits tax by §122(a) of the Revenue Act of 1945, for taxable years beginning after December 31, 1945, was fully effective for fiscal 1948, although the tax remained "in force for the purposes of the determination of the taxes imposed" for fiscal 1946 (*id.*, §122(b)). The adjustment to the fiscal 1948 net operating loss is required by the statute only "if the excess profits credit for such taxable year [fiscal 1948] *was computed* under section 714" (§711(a)(2)(L)(i)). But no excess profits credit at all was computed for fiscal 1948. The tax for that year was not in existence. Since no excess profits credit was computed for fiscal 1948, it could not have been computed under §714 or §713 or any other section, and the condition

precedent to the requirement for the interest adjustment is not satisfied.

The Court below, although admitting the equity of the Petitioner's contention, thought the concluding words of § 122 (b) of the Revenue Act of 1945 that the determination of fiscal 1946 taxes is "to be made as if subsection (a) [the repealing section] had not been enacted . . ." put upon the taxpayer the burden of showing that its "theoretical excess profits credit" for fiscal 1948 "was not properly computed". If the excess profits tax had been in effect in fiscal 1948, no doubt the taxpayer would have computed an excess profits credit. It is entirely irrelevant, however, to speak of how the excess profits credit "would have been computed" when, in fact, the excess profits tax (and all related provisions of the statute including the definition of the excess profits credit) had been repealed for all purposes so far as fiscal 1948 is concerned.

A would-be computation of the excess profits credit for fiscal 1948 is not the statutory test. Section 711(a)(2)(L)(i) requires the interest adjustment only if the credit for that year *was computed* under § 714. No credit was computed for that year, either by the taxpayer, by the United States or by anyone else. Where none was computed, the adjustment is not required.

2. If the Words "Was Computed" Must Be Read "Would Have Been Computed", the Proper Computation Would Be Pursuant to the Income Method and No Adjustment for Interest Is Authorized.

Let us assume that the excess profits tax provisions remained in effect for fiscal 1948,[4] though they did not. As we

[4] For this purpose, however, we must eliminate the provisions relating to the carry-back of an unused excess profits credit, for this is specifically required by § 122(c) of the Revenue Act of 1945.

have seen, the net operating loss deduction adjustment for fiscal 1946 is to be made only if the excess profits credit for fiscal 1948 "was computed under section 714" (§711(a)(2)(L)(i)). The credit for fiscal 1948 is required to be computed under the invested capital method (§714) or the income method (§713), "whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed" (§712).

In fiscal 1948 the Petitioner did not have any income subject to tax, excess profits or otherwise. It sustained a net loss in that year. Accordingly, had the excess profits tax then been in effect, no excess profits tax would have been payable in respect of fiscal 1948. The computation of the excess profits credit, whether made under §714 or §713 (or if not made at all), would result in a tax liability of zero, and neither credit computation results in a "lesser" excess profits tax for fiscal 1948 than the other. Accordingly, fiscal 1948 cannot be "the taxable year" in respect of which the excess profits tax "is being computed" (§712 above).

The only other "taxable year for which the tax under this subchapter is being computed" is fiscal 1946. Under the facts applicable to the Petitioner as shown from the record here, if a theoretical excess profits credit for fiscal 1948 is to be computed, it must be computed under the income method provided by §713, for, as the United States admits, computation under that section rather than under §714 "results in the lesser tax under this subchapter for the taxable year [fiscal 1946] for which the tax under this subchapter is being computed" (§712 above).

Since the theoretical excess profits credit for fiscal 1948, if one is required, must be computed under §713, the adjustment for interest to the net operating loss carry-back is

not required. The decision of the Court below is equally wrong on this analysis.

REASONS FOR GRANTING THE WRIT

1. General Importance of the Question

The importance of an orderly administration and uniform application of the revenue laws of the United States does not need to be emphasized. The objective of a uniform application of the revenue laws, as this Court has pointed out,[5] is accomplished largely by the function of the Tax Court of the United States, and perhaps it is unfortunate for the Petitioner here that the Tax Court did not have jurisdiction to consider this case. That resulted from the fact that the fiscal 1948 net operating loss resulted in an overpayment rather than a deficiency for fiscal 1946.

In cases, such as this, of great complexity involving a maze of interrelated statutory provisions the lower Federal courts should be instructed whenever possible by this Court. Until the question is settled the Commissioner will continue to take conflicting positions.[6] Furthermore, since the same statutory provisions are contained in the current excess profits tax statutes,[7] a decision here will be determinative of questions arising not only under the World War II law but also under the present law.

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[5] See, for example, *Dobson* v. *Commissioner*, 320 U. S. 489 (1944).

[6] It was admitted in the brief for the United States in the Court below that it had made a contrary argument, which was sustained, in *Aluminum Products Co.* v. *United States*, 101 F. Supp. 373 (Ct. Cls., 1951), although that case was said to be distinguishable. The Commissioner has not promulgated regulations that govern the issue in this case.

[7] Internal Revenue Code, § 433(a)(1)(J).

2. Decisions of Other Courts

On the precise issue involved, this is a case of first impression. Thus, although the Petitioner has been advised of other cases in the process of litigation, there are no other decisions directly conflicting with the decision of the Court below.

The Court of Claims has decided two cases involving the carry-back of unused excess profits credit or of a net operating loss for excess profits tax purposes that appear to conflict in principle with the decision of the Court below.[8]

CONCLUSION

The Petitioner submits, therefore, that this case presents a matter of substantial importance in the administration of the revenue laws which should properly be determined by this Court.

The Petitioner, accordingly, prays that a writ of certiorari issue to bring before this Court for review the judgment of the Court below.

Dated March 17, 1953.

Respectfully submitted,

H. BRICE GRAVES
JOHN W. RIELY
Electric Building
Richmond 12, Virginia
Counsel for Petitioner

HUNTON, WILLIAMS, ANDERSON,
GAY & MOORE
Of Counsel

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[8] *Aluminum Products Co.* v. *United States*, *supra*, note 6; *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109 (1952), *id.*, 53-1 USTC ¶9233 (March 3, 1953).

Internal Revenue Code

Section 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

* * *

(s) *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

Section 122. Net Operating Loss Deduction.

(a) *Definition of Net Operating Loss.*—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-back and Carry-over.*—

(1) *Net Operating Loss Carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding years except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * *

(c) *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d), (1), (2), (3), and (4) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e)).

Section 711. Excess Profits Net Income.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be made:

(1) *Excess Profits Credit Computed Under Income Credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * *

(J) *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits

tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; and

* * *

(2) *Excess Profits Credit Computed Under Invested Capital Credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * *

(B) *Interest.*—The deduction for interest shall be reduced by an amount equal to 50 per centum of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719 (a));

* * *

(L) *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; and

Section 712. Excess Profits Credit—Allowance.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed.* * *

Revenue Act of 1945

Section 122. *Repeal of Excess Profits Tax in 1946.*

(a) *In General.*—The provisions of subchapter E of chapter 2 [providing for the excess profits tax] shall not apply to any taxable year beginning after December 31, 1945.

(b) *Carry-backs from Years After 1945, etc.*—Despite the provisions of subsection (a) of this section the provisions of subchapter E of chapter 2 shall remain in force for the purposes of the determination of the taxes imposed by such subchapter for taxable years beginning before January 1, 1946, such determination to be made as if subsection (a) had not been enacted but with the application of the amendments made by subsection (c) of this section and section 131 of this Act.

(c) *Unused Excess Profits Credit for Taxable Year Beginning After December 31, 1945.*—Section 710(c)(2) (defining the unused excess profits credit) is amended by inserting at the end thereof a new sentence reading as follows: "There shall be no unused excess profits credit for a taxable year beginning after December 31, 1946. The unused excess profits credit for a

taxable year beginning in 1946 and ending in 1947 shall be an amount which is such part of the unused excess profits credit determined under the preceding provisions of this paragraph as the number of days in such taxable year prior to January 1, 1947, is of the total number of days in such taxable year.

Section 131. *Fiscal Year Taxpayers.*

* * *

(b) *Excess Profits Tax.*—

(1) *In General.*—Section 710(a) (imposing the excess profits tax) is amended by inserting at the end thereof the following:

"(7) *Taxable Years Beginning in 1945 and Ending in 1946.*—In the case of a taxable year beginning in 1945 and ending in 1946, the tax shall be an amount equal to that portion of a tentative tax, computed as if the law applicable to taxable years beginning on January 1, 1945, were applicable to such taxable year, which the number of days in such taxable year prior to January 1, 1946, bears to the total number of days in such taxable year."